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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

JOHN NUVEEN & CO., INC., a corporation, INVESTORS SYNDICATE OF AMERICA, INC., a corporation, and INVESTORS DIVERSIFIED SERVICES, INC., a corporation

Petitioners,

v.

HENRY T. SANDERS, et al.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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Respondents.

QUESTIONS PRESENTED

1. Whether the "reasonable care" defense in Section 12(2) of the Securities Act of 1933 is (as construed by the court below) equivalent to, or is even more stringent than, the "reasonable investigation" defense in Section 11 of that Act, notwithstanding that (a) Congress used different, seemingly less onerous statutory language in Section 12(2) and (b) Section 12(2) applies to sales of securities generally (including sales of exempt commercial paper), whereas Section 11 applies only to the special category of registered public offerings of securities.

2. Whether, in order to exercise "reasonable care" under Section 12(2), a seller of securities must independently verify the accuracy of a certified financial statement although no such burden is imposed by Section 11.

3. Whether, in order to establish in an action under Section 12(2) that a security was sold to the plaintiff "by means of a

prospectus", plaintiff need only prove that a small number of *other* purchasers received the prospectus before making their purchases, as distinguished from proving that the plaintiff himself received the prospectus before he made his purchase.

PARTIES TO THE PROCEEDING

The defendants below are the petitioners herein, John Nuveen & Co., Inc. ("Nuveen"), Investors Syndicate of America, Inc. ("ISA") and Investors Diversified Services, Inc. ("IDS"). This action was certified as a class action on October 19, 1972. Subsequent to the entry of the District Court's initial judgment against defendants, the action proceeded on a multiple plaintiff basis, with each plaintiff participating individually, through counsel.[1]

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[1]The plaintiffs are Robert Abram; Dimmy Andrews; Harry H. Bass; Calumet-Dutch Packing Co.; Capitol Bank and Trust Co. of Springfield; Citizens State Bank of Montgomery, Minn; Jennie M. Clark; M.K. Clark & Co.; Denver National Bank; Mrs. Katherine E. Doolittle; Down East Enterprise Profit Sharing Plan; Elgin Nat'l Industries, Inc. Employees' Relief Fund; William M. Frew; Greenview Community Bank; Harbor Square Corporation, formerly Down East Enterprise, Inc.; Harmony State Bank; Hogan & Farwell, Inc.; Jackson National Life Insurance Company; Clifford M. and Eugene M. Johnson, as Trustees for Thora M. Johnson; Russell C. Kuehl; Kuehl Brothers; LaCrescent State Bank; Lawrenceville National Bank & Trust Co.; Marquette-Lake State Bank, formerly Chicago Lake State Bank; Midland Community Bank; Lawrence W. Morley; National Stock Yards National Bank; Carl T. Nelson, Jr.; Q.R.F. Corporation; Angela Raphael and Dorothea R. Coffin; Frank G. Raphael; Henry T. Sanders; S.C. Smiley & Associates; Second Boulevard Realty & Ins. Co.; Phyllis Shapiro; Elizabeth Sorenson (Effie L. Smith, Administrator); Stovall & Stovall, Inc.; Gerald R. Tapp: Trinity Grace United Methodist Church; and Freida Wallner (Ingeborg W. Smith, Executor).

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petitioners John Nuveen & Co., Inc., Investors Syndicate of America, Inc. and Investors Diversified Services, Inc. respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit entered in this action on April 29, 1980.

OPINIONS BELOW

The Court of Appeals has rendered four opinions in separate appeals in this action. The most recent opinion ("*Sanders IV*") is officially reported at 619 F.2d 1222 and is printed in the separately bound appendix to this petition. (A. 2) The order of the Court of Appeals denying rehearing is printed in the appendix. (A. 1) The opinion of the United States District Court for the Northern District of Illinois, Eastern Division, and the orders from which that appeal was taken, not officially reported, are printed in the appendix. (A. 15, 18, 19, 20)

The first opinion of the Court of Appeals in this action is reported at 463 F.2d 1075 (7th Cir. 1972), *cert. denied*, 409 U.S. 1009 (1972) ("*Sanders I*"), and is printed in the appendix. (A. 82) The second opinion of the Court of Appeals is reported at 524 F.2d 1064 (1975) ("*Sanders II*") and is printed in the appendix. (A. 63) That decision was vacated and remanded by this Court at 425 U.S. 929 (1976). This Court's order is printed in the appendix. (A. 62) The opinion of the Court of Appeals on remand from this Court is reported at 554 F.2d 790 (1977) ("*Sanders III*") and is printed in the appendix. (A. 46)

JURISDICTION

The judgment of the United States Court of Appeals for the Seventh Circuit sought to be reviewed was entered on April 29, 1980. A timely petition for rehearing was denied on May 30, 1980. This petition for certiorari was filed within ninety days of that date. This Court's jurisdiction is invoked under 28 U.S.C. §1254(1).

STATUTES INVOLVED

Sections 11 and 12 of the Securities Act of 1933 ("1933 Act"), 15 U.S.C. §§77k and 77*l*, are set forth in the statutory appendix at the end of this petition.

STATEMENT OF THE CASE

A. The Transactions And Parties Involved

1. The Defendants-Petitioners

At all times material hereto Nuveen was a broker-dealer registered with the Securities and Exchange Commission ("SEC"). In September of 1968, Nuveen acquired the business of Ashwell & Co. ("Ashwell"), a dealer in short-term promissory notes (hereinafter referred to as "commercial paper").[2] On September 15, 1969, ISA, a wholly-owned subsidiary of IDS, acquired all of the stock of Nuveen.

2. Winter & Hirsch, Inc.

Winter & Hirsch, Inc. ("Winter & Hirsch") was one of the companies whose commercial paper was sold by Ashwell (since

[2]Commercial paper consists of unsecured, short-term promissory notes, payable to the bearer at a stated maturity, never more than 270 days. The notes are either interest-bearing notes or notes issued and sold at a discount from the face amount, which do not bear interest.

the 1930's) and later by Nuveen. Winter & Hirsch was a consumer finance company which had been in business in Chicago since 1915 and was held in very high regard by financial institutions. Winter & Hirsch obtained funds to lend from various sources, including unsecured bank loans, long-term loans, and the sale of commercial paper. As Nuveen knew, more than seventy banks, including forty Chicago-area banks, lent money to Winter & Hirsch during the period at issue in this case.[3]

3. Lieber, Bleiweis And Company

At all times material hereto, and beginning some time prior to 1960, the certified public accounting firm of Lieber, Bleiweis and Company ("Lieber, Bleiweis") and predecessors thereto purported to audit the financial statements of Winter & Hirsch on a semi-annual basis and issued opinions on those financial statements. Lieber, Bleiweis was duly licensed to practice public accounting in the State of Illinois.

Nuveen, as well as the major bank and insurance company lenders to Winter & Hirsch, all relied upon the audit reports issued by Lieber, Bleiweis. In both *Sanders II* and *Sanders IV* the Court of Appeals assumed for purposes of its decisions that, as petitioners contended, the audit reports were not defective on their face or qualified in any way and that nothing in the audit reports themselves gave Nuveen any reason to question their accuracy.[4] (*Sanders II*, A. 68-69; *Sanders IV*, A. 11 n. 10)

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[3]Eleven of the fifty largest banks on the Fortune Directory were lenders to Winter & Hirsch in this period. FORTUNE, July, 1974, p. 114.

[4]The SEC, as amicus curiae in *Sanders III*, agreed that the "audit report itself raised no necessity for further inquiry." Brief of the Securities and Exchange Commission, Amicus Curiae ("SEC Br.") at 68. Petitioners have lodged a copy of that brief with this Court.

4. The Plaintiffs-Respondents

The forty-two plaintiffs, including the named plaintiff-respondent Henry T. Sanders, purchased Winter & Hirsch commercial paper from Nuveen with an aggregate face amount of approximately $1,600,000.[5]

B. Nuveen's Investigations Of Winter & Hirsch

Prior to the first sale of Winter & Hirsch commercial paper at issue here, Nuveen made an extensive investigation of Winter & Hirsch. In December, 1968, Nuveen's experienced commercial paper credit analyst thoroughly reviewed the most recent financial statements of Winter & Hirsch, which Lieber, Bleiweis had certified. In March, 1969, the analyst spent an entire day at Winter & Hirsch meeting with its officers and making a check of its records. He sought verification, on a spot check basis, of management's statements with respect to delinquency experience and collection procedure for delinquent accounts and of the authenticity of the loans shown in the files, that is, that Winter & Hirsch had proper documentation to support the accounts receivable ledger cards. Management's statements were verified and nothing in that on-site examination disclosed any adverse information about Winter & Hirsch.

In accordance with its usual practice Nuveen made written inquiry of banks that were lenders to Winter & Hirsch. The responses to these letters raised no questions about the sound financial condition of Winter & Hirsch and were generally laudatory.

In late 1969 a subsequent financial statement of Winter & Hirsch, also certified by Lieber, Bleiweis, was reviewed by

[5]As a result of payments on behalf of Winter & Hirsch, net claims against the petitioners aggregate approximately $477,000, exclusive of pre- and post-judgment interest. Plaintiffs' attorneys have been awarded fees of $395,000 in respect of their services through the proceedings prior to *Sanders IV*, to be paid out of any amount ultimately awarded to plaintiffs. (A. 15, 17)

Nuveen. In early 1970 further inquiries were made by Nuveen of bank lenders. Again, everything appeared to be in order.

C. Discovery Of The Winter & Hirsch Fraud

In the fall of 1969 rumors about Winter & Hirsch began to reach a few of its lenders. (None of the rumors reached Nuveen.) As a result of pressure from two of these lenders, on January 9, 1970 Winter & Hirsch retained another public accounting firm, Peat, Marwick, Mitchell & Co. ("Peat, Marwick"), to conduct an audit as of January 31, 1970.

Nuveen first learned of the special audit on February 10, 1970. Despite importunings from one of Winter & Hirsch's bank lenders, Nuveen immediately ceased selling Winter & Hirsch commercial paper.

Approximately five weeks after its audit had begun, Peat, Marwick discovered a discrepancy of approximately $14,000,000 between Winter & Hirsch's actual accounts receivable and the total shown in the most recent Lieber, Bleiweis audit report. Following this discovery, all payment of Winter & Hirsch debt, including the commercial paper sold by Nuveen and owned by plaintiffs, was suspended.

It was subsequently determined that the discrepancy resulted from a fraudulent inflation of the firm's books by the management of Winter & Hirsch. This had occurred piecemeal over a period of ten years or more in collusion with Lieber, Bleiweis. Despite its certificate to the contrary, Lieber, Bleiweis had not audited Winter & Hirsch but instead had relied largely on information supplied by management. The principals of both Winter & Hirsch and Lieber, Bleiweis ultimately pleaded guilty to federal criminal fraud charges.

D. Proceedings Below And Before This Court

On March 12, 1970, Sanders filed a class action complaint against thirteen defendants, including Nuveen, IDS and ISA.[6] Sanders contended that petitioners had violated certain provisions of the federal securities laws[7] in connection with the sale by Nuveen of the commercial paper issued by Winter & Hirsch during an eight-month period beginning in June, 1969.

The District Court denied petitioners' motion contending that the short-term promissory note purchased by Sanders was not a "security" subject to the provisions of the 1934 Act. The question was certified to the Court of Appeals for the Seventh Circuit pursuant to 28 U.S.C. §1292(b). The Court of Appeals granted permission to appeal and in its first opinion, *Sanders I*, held that the note was a "security". Accordingly the court ordered a trial on the merits.[8]

Following trial the District Court found in favor of plaintiffs and against the petitioners. In its second opinion in this case, *Sanders II*, the Court of Appeals affirmed the judgment against Nuveen, ISA and IDS, holding that Nuveen had violated Rule 10b-5 by breaching its obligations as an "underwriter" of a security, that "Nuveen's investigation of [Winter & Hirsch] was deficient, and that an appropriate investigation would have

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[6]Nine defendants other than those named above were dismissed by stipulation with the approval of the District Court. In *Sanders II* the Court of Appeals reversed the District Court's judgment imposing liability on a tenth defendant, Alleghany Corporation. (A. 75)

[7]The complaint as amended to the present has asserted claims under Sections 12(1), 12(2) and 17 of the 1933 Act, 15 U.S.C. §§77*l*(1), 77*l*(2) and 77q, respectively; Sections 10(b) and 20 of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. §§78j(b) and 78t, respectively; Rule 10b-5 promulgated by the SEC under the 1934 Act, 17 C.F.R. §240.10b-5; and certain of the Rules of Fair Practice of the National Association of Securities Dealers, Inc.

[8]Petitioners thereafter sought certiorari to this Court. The petition was denied. 409 U.S. 1009 (1972).

revealed the fraud." (A. 72) The decision in *Sanders II* was vacated by this Court and was remanded for reconsideration by the Court of Appeals in light of *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976). 425 U.S. 929 (1976). (A. 62)

On remand from this Court, in *Sanders III* the Court of Appeals reversed the judgment of the District Court, holding that Nuveen had not violated Rule 10b-5 because it had not acted with scienter. (A. 47-50) The Court of Appeals also refused to impose liability on several other theories urged by plaintiffs (A. 51-58), but remanded this case to the District Court so that that court could make findings and conclusions under Section 12(2) of the 1933 Act, another claimed basis for liability which had been alleged from the outset but with respect to which no findings had been made following the trial. (A. 58-60) Over defendants' objection the District Court thereafter granted plaintiffs leave to file an amendment to the complaint asserting a claim under Section 12(1) of the 1933 Act, a cause of action on which plaintiffs had previously disclaimed reliance. (A. 52, 60-61)

After an evidentiary hearing, the District Court entered a judgment holding Nuveen liable to all plaintiffs under both Sections 12(1) and 12(2).[9] (A. 20-45) In *Sanders IV* the Court of Appeals affirmed the judgment of the District Court on the ground that Nuveen was liable to the plaintiffs under Section 12(2), without reaching the Section 12(1) claim.[10] (A. 2)

BASIS FOR FEDERAL JURISDICTION

Jurisdiction of this action in the District Court was predicated upon Section 22 of the 1933 Act, 15 U.S.C. §77v.

[9]The liability of petitioners ISA and IDS is predicated solely upon their status as controlling persons of Nuveen, as determined by the Court of Appeals in *Sanders II*. (A. 73-75) No issue is presented herein as to their liability apart from the underlying liability of Nuveen.

[10]In *Sanders III*, however, when the SEC had urged Nuveen's liability under Section 12(1), the Court of Appeals expressed "great doubt" about such liability. (A. 52)

REASONS FOR GRANTING THE WRIT

Section 12(2) of the 1933 Act provides that when a security is offered or sold "by means of a prospectus or oral communication" which includes an untrue statement of material fact or omits to state a material fact necessary in order to make the statements made not misleading, the purchaser may recover from the seller. The statute exculpates the defendant, however, if he proves that "he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission." The Court of Appeals, in contravention of numerous recent decisions of this Court with respect to the proper construction of the federal securities laws, erred in holding (i) that Nuveen sold Winter & Hirsch commercial paper to all plaintiffs by means of an actionable prospectus which most of the plaintiffs never received and (ii) that Nuveen failed to establish its reasonable care defense. Review of the decision below is necessary to clarify several central elements of a claim under Section 12(2), an express civil liability provision sought to be used with increasing frequency in light of the limitations imposed by this Court on the scope of Rule 10b-5. *See, e.g., Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).

I. THE RULING BELOW THAT THE "REASONABLE CARE" DEFENSE IN SECTION 12(2) OF THE SECURITIES ACT OF 1933 REQUIRES A MORE EXTENSIVE INVESTIGATION OF AN ISSUER OF SECURITIES THAN DOES SECTION 11 OF THAT ACT IS IN CONFLICT WITH FUNDAMENTAL PRINCIPLES UNDERLYING DECISIONS OF THIS COURT, THE POSITION OF THE SECURITIES AND EXCHANGE COMMISSION AND THE STATUTORY PATTERN OF THAT ACT.

Two principles underlie this Court's many recent decisions interpreting the federal securities laws.

First, the principal, if not exclusive, source to which a court must turn when interpreting the provisions of the federal securi-

ties laws is the words of the particular provisions themselves. *Aaron v. Securities and Exchange Commission*, 100 S.Ct. 1945, 1955 (1980); *Touche Ross & Co. v. Redington*, 442 U.S. 560, 568 (1979); *Int'l Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 558 (1979); *Santa Fe Industries v. Green*, 430 U.S. 461, 472, 477 (1977); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 200-201 (1976); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring); *Reliance Electric Co. v. Emerson Electric Co.*, 404 U.S. 418, 424, 427 (1972).

Second, and equally important, a court must read all of the express and implied civil liability provisions of the federal securities laws together to avoid anomalous results. *Touche Ross & Co. v. Redington*, 442 U.S. 560, 571-74 (1979); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 206-11 (1976); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 736 (1975). *See also Aaron v. Securities and Exchange Commission*, 100 S.Ct. 1945, 1955-57 (1980).

The Court of Appeals violated both of these principles (i) by holding that there is "no significance" to the difference in language between Sections 11 and 12(2) (A. 11), (ii) by holding that the "reasonable care" defense in Section 12(2) of the 1933 Act creates the same duties for a seller of securities as the "reasonable investigation" defense in Section 11 creates for an underwriter and (iii) by holding that liability may be imposed under Section 12(2) for the failure to conduct a more thorough investigation than would have been required under Section 11.

A. The Statutory Pattern

Section 11(a) of the 1933 Act imposes liability on certain persons, including underwriters,[11] in connection with sales of securi-

[11] In the 1933 Act the concept of an "underwriter", defined in Section 2(11), 15 U.S.C. §77b(11), has meaning only under Section 11, which refers explicitly to underwriters, and under provisions relating to the registration requirements and to liability for failure to comply therewith, namely Sections 5, 4(1) and 12(1), 15 U.S.C. §§77e, 77d(1) and 77*l*(1), respectively.

ties in a registered public offering pursuant to a registration statement which is materially false. Section 11(b) sets forth defenses for all defendants other than the issuer. In particular, an underwriter of a registered public offering is not liable if it proves:

> that (A) as regards any part of the registration statement not purporting to be made on the authority of an expert . . . [it] had, after *reasonable investigation*, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading; . . . and (C) as regards any part of the registration statement purporting to be made on the authority of an expert (other than himself) . . . [it] *had no reasonable ground to believe, and did not believe*, at the time such part of the registration statement became effective, that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading. . . .

Section 11(b)(3) (emphasis added). Thus, for example, an underwriter in a registered public offering of securities is exculpated if it did not believe and had no reasonable ground to believe that an "expertised" portion of the registration statement, such as a certified financial statement,[12] was false. As to "expertised" portions, therefore, a defendant (including an underwriter) has no affirmative obligation to make any investigation.[13]

Unlike Section 11, which expressly imposes liability on particular persons, Section 12(2) applies to "[a]ny person . . . who

[12]A certified financial statement is a "statement purporting to be made on the authority of an expert" within the meaning of Section 11(b)(3)(C). Section 11(a)(4).

[13]The original Section 11(b)(3)(C) had imposed an affirmative "reasonable ground to believe and did believe" burden with regard to expertised portions. Securities Act of 1933, Pub.L. 22, §11(b)(3)(C) (1933). This was changed to the present form in 1934. Amendments to Securities Act of 1933, Pub.L. 291, §206(b) (1934).

offers or sells a security"—there is no singling out of a category of underwriters. Moreover, Section 12(2) applies to all sales of securities, whether or not made, or required to be made, pursuant to a registration statement. Liability lies under Section 12(2) unless the seller "did not know, and *in the exercise of reasonable care* could not have known, of [the] untruth or omission." (emphasis added)

B. The "Reasonable Care" Defense Of Section 12(2) Does Not Require, As The Court Of Appeals Held, A "Reasonable Investigation" Sufficient To Satisfy Section 11

In framing defenses in consecutive sections of the 1933 Act, Congress used different language in dealing with different situations: "reasonable investigation" under Section 11 in the special case of registered offerings and "reasonable care" under Section 12(2). Such distinctions in language cannot be ignored, since "[a]scertainment of congressional intent with respect to the standard of liability created by a particular section of the [1933 and 1934] Acts must . . . rest primarily on the language of that section." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 200 (1976). The distinctions in language and context between Sections 11 and 12(2) make clear that the burden of "investigation" imposed in the registration context is greater than the burden of "care" imposed in all circumstances by Section 12(2). Indeed, the very word "investigation" denotes a duty greater than mere "care".[14]

Shortly after the passage of the 1933 Act, two commentators observed that the standard under Section 12(2) is "*merely* that of 'reasonable care'." William O. Douglas and George E. Bates, "The Federal Securities Act of 1933," 41 YALE L.J. 171, 208 (1933) (footnote omitted; emphasis added). The standard of

[14] *Compare* this Court's analysis of the ordinary meaning of the words used in Rule 10b-5 (*Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197-200 (1976)) and in Section 17(a) of the 1933 Act (*Aaron v. Securities and Exchange Commission*, 100 S.Ct. 1945, 1955 and n. 13 (1980)).

reasonableness under Section 12(2) "presumably is somewhat less exacting" than under Section 11. *Id.*, at n. 205. In its amicus brief in *Sanders III* the SEC stated that the Section 11 and Section 12(2) defenses are not the same and vigorously opposed imposing Section 11 investigation burdens on a Section 12(2) seller. (SEC Br. 69-71, 74; *see also* pp. 14-15, *infra*). *See also Lanza v. Drexel & Co.*, 479 F.2d 1277, 1309 (2d Cir. 1973) (refusing to impose Section 11 standards applicable to directors in an action under Rule 10b-5).

The court below completely ignored the patent distinction between these two sections in summarily "find[ing] no significance in this difference in language in the case at bar." (A. 11) The court merely adopted the analysis in *Sanders II*, where it had held, relying almost exclusively on Section 11 precedents, that Nuveen had breached its duty as an underwriter of commercial paper.[15] (*Sanders II*, A. 68-73; *Sanders IV*, A. 11-13) "[T]he *reasonable care* standard required the *reasonable investigation* described in *Sanders II*." (*Sanders IV*, A. 13) (emphasis added).

C. The Court Of Appeals Imposed A Greater Burden Under Section 12(2) Than Under Section 11, Thereby Completely Ignoring The Statutory Pattern Of The Securities Act of 1933

Not only did the court below erroneously rely upon Section 11 precedents to delineate the "reasonable care" standard of Section 12(2), but it actually imposed a burden greater than that which exists under Section 11.

In the context of a registered public offering Section 11(b)(3)(C) explicitly exonerates a defendant sued in connection with a false certified financial statement in the registration statement where the defendant merely "had no reasonable ground to

[15] In *Sanders II* the Court of Appeals was considering Nuveen's liability under Rule 10b-5. Section 12(2) was not addressed at all. (A. 68)

believe and did not believe" that the financial statement was misleading. *See Escott v. BarChris Construction Corp.*, 283 F.Supp. 643, 697 (S.D.N.Y. 1968) (underwriter held liable as to some portions of the registration statement but not as to the false certified financial statements). *See also* 3 Loss, *Securities Regulation* 1726-27 (2d ed. 1961).

In *Sanders IV*, as it had done in *Sanders II*, the Court of Appeals assumed that the Lieber, Bleiweis audit reports "on their face, gave Nuveen no reason to question their accuracy."[16] (*Sanders IV*, A. 11 n. 10; *Sanders II*, A. 68-69) The Court of Appeals also held that Nuveen had an "honest belief that the financial statements [of Winter & Hirsch] prepared by certified public accountants correctly represented [its] financial condition." (*Sanders II*, A. 63, quoted in *Sanders IV*, A. 5). Therefore, if the instant claims had arisen in connection with a registration statement Nuveen would have been exonerated under Section 11(b)(3)(C). The Court of Appeals held, however, that Nuveen failed to exercise reasonable care because it did not investigate the accountants' workpapers, and that Nuveen should have "determin[ed] the basic integrity of the issuer's financial statements." (*Sanders II*, A. 72, followed in *Sanders IV*, A. 10-13)

In imposing a duty of verification of an accountant's report in these circumstances, the decision below thus set a standard of care greater than that imposed by Section 11 and *a fortiori* far beyond that applicable to a seller under Section 12(2). (As discussed in the next section of this petition, the SEC shares this criticism.) Requiring an underwriter or other seller to go behind a certified financial statement is unprecedented.

> [A]bsent actual knowledge or warning signals, a broker-dealer should not be under a duty to retain his own auditor to

[16]The District Court held that the audit reports raised questions on their face. (A. 41-42) However, throughout the Court of Appeals has assumed that these findings were in error, and in its amicus brief in *Sanders III* the SEC expressed concurrence with that view of the evidence. (SEC Br. 15 n. 26, 68)

> re-examine the books of every company, the stock of which he may offer for sale, even accepting the doubtful hypothesis that such permission would be granted.

Levine v. Securities and Exchange Commission, 436 F.2d 88, 90 (2d Cir. 1971).

It would be anomalous and contrary to the decisional rationale of *Ernst & Ernst v. Hochfelder*, 425 U.S. at 210, to hold a defendant liable under Section 12(2) for relying on an unqualified auditors' report when the immediately preceding section of the same statute—on its face imposing a more severe test ("reasonable investigation" rather than "reasonable care")—expressly provides that such reliance is not negligent. *See also Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 752-54 (1975).

D. In Its Amicus Brief In *Sanders III* And In A General Analysis Of The Commercial Paper Market The SEC Has Concluded That An Underwriter Of Unregistered Commercial Paper Need Not Conduct A Section 11 "Reasonable Investigation," Particularly With Respect To Certified Financial Statements

In its amicus brief filed with the court below in *Sanders III* the SEC was expressly critical of the *Sanders II* ruling which held Nuveen liable for failing to verify the accuracy of the Lieber, Bleiweis audit report. The requirement to review accountants' workpapers "could prove too strict and too rigid." (SEC Br. 68) The SEC continued:

> We believe that it would be inconsistent with the statutory scheme to apply precisely the same standards to the scope of an underwriter's duty under Section 12(2) as the case law appropriately has applied to underwriters under Section 11. . . . Since Congress has determined that registration is not necessary in certain defined situations, we believe that it would undermine Congressional intent—that issuers and

> other persons should be relieved of the burden of registration—if the same degree of investigation were to be required to avoid potential liability whether or not a registration statement is required.

SEC Br. 69. *See also* SEC Br. 70-71.[17]

The SEC has elsewhere pointed out that the type of inquiry made by a commercial paper dealer is not as exhaustive as the investigation mandated by Section 11 in connection with registered offerings:

> [T]here is no investigation undertaken by the [commercial paper] dealer which would even approximate that which is required of an underwriter of a security offering registered with the Commission pursuant to the 1933 Act.[18]

In making the foregoing statement, which was written after the events at issue in this case, the SEC did not suggest that these practices by a dealer were unlawful.

E. The Ruling Below May Have A Significant Dampening Effect On The Commercial Paper Market

There are substantial practical considerations which support the distinction between Sections 11 and 12(2) established by

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[17]In *Sanders III* the SEC took the position that if the Winter & Hirsch commercial paper was exempt from registration Nuveen had met its burden of reasonable care. (SEC Br. 54, 74, 76) The SEC also contended, contrary to petitioners' position, that the standard of reasonable care is higher when the securities are not exempt, that the Winter & Hirsch commercial paper was not exempt (*but see* p. 7, n. 10, *supra*) and that Nuveen had failed to meet the higher standard of reasonable care purportedly applicable in those circumstances. (SEC Br. 60-61, 76)

[18]Staff Report of the Securities and Exchange Commission to the Special Subcommittee on Investigations, "The Financial Collapse of the Penn Central Company" 273-74 (1972).

Congress. The obliteration of this distinction by the court below may have a significant dampening effect on a very important element of this country's credit markets.[19]

Commercial paper is used by businesses with fluctuating cash needs and is sold on a recurring basis, as needed, to meet the issuer's current requirements for short-term financing. Under Section 12(2), liability is determined as of the date of each sale. This is to be contrasted with an underwriter's liability under Section 11, which is determined as of the effective date of the registration statement. Folk, "Civil Liabilities under the Federal Securities Acts: The *BarChris* Case," 55 VA.L.REV. 199, 263 (1969). Thus while a seller of unregistered commercial paper has a continuing obligation to exercise "reasonable care" as regards facts communicated by it about the issuer, the underwriter of a registered offering need make only a single "investigation".

If Section 11 investigation burdens were imposed so that a commercial paper dealer were obligated to conduct a continuous full scale "due diligence" investigation typical in registered public offerings, it would eliminate from commercial paper markets those issuers that could not afford to pay the increased commission or spread necessary to compensate the dealer for undertaking

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[19]As of April 30, 1980, the amount of commercial paper outstanding in the United States exceeded 120 billion dollars, of which over 18 billion dollars had been sold by dealers. 66 FEDERAL RESERVE BULLETIN, June, 1980, at A25. Early in 1980, when interest rates on long-term debt soared, commercial paper became an increasingly important source of funds. "With interest rates on long-term bonds at an all-time high, senior financial officers of the nation's major companies are seeking alternative sources of funds by turning to stock offerings, short-term borrowings from major banks, commercial paper and foreign banks." New York Times, March 3, 1980, page D1. *See also* "New Era for Banking," BUSINESS WEEK, April 21, 1980, page 92 (commercial paper provided a critical source of financing in the Spring, 1980 credit crunch).

that kind of perpetual investigation.[20] The SEC shared this concern as amicus in *Sanders III*:

> If a very heavy burden of investigation into the creditworthiness of each issuer were to be placed upon commercial paper dealers going considerably beyond the reliance on audit reports for assessment of short-term prospects, the spontaneity of the market would probably be impeded and the expenses of detailed investigations might raise costs considerably. Indeed, to require an underwriter of unregistered commercial paper to examine all of the corporate minutes, schedules of delinquencies, correspondence with creditors and customers, financing agreements, inventories, and the like, would impose such an onerous burden upon them as conceivably to make impracticable the market for such securities.

SEC Br. 70-71.

If the correct interpretation of "reasonable care" had been applied in this case, Nuveen would not have been held liable. *See* SEC Br. 73-76. Nuveen's exercise of reasonable care was thwarted by the deliberate, collusive fraud of the issuer and its independent accountant. The record established that Nuveen's efforts exceeded prevailing industry standards. Nuveen thoroughly examined the certified financial statements of Winter & Hirsch, interviewed the issuer's officers, reviewed delinquency and other original records of the issuer and communicated with the issuer's lenders. No more should have been required in these circumstances.

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[20]The commercial paper dealer typically collects a commission of one-eighth or one-quarter of a percentage point. Staff Report of the Securities and Exchange Commission to the Special Subcommittee on Investigations, "The Financial Collapse of the Penn Central Company" 274 (1972). (Nuveen made a gross profit of $65.02 on Sanders' purchase of $34,245.31, or 0.19%.) The underwriting spread in large, higher grade public offerings of equity securities is 6½% to 8%. Robinson and Eppler, GOING PUBLIC §6, p. 13 (1978 Revision).

II. THE COURT BELOW REPLACED THE ELEMENT OF CAUSATION UNDER SECTION 12(2) WITH AN IRREBUTTABLE PRESUMPTION. THIS SUBSTANTIALLY BROADENED SECTION 12(2) IN A MANNER INCONSISTENT WITH THIS COURT'S MANDATE THAT EACH PROVISION OF THE FEDERAL SECURITIES LAWS BE INTERPRETED CONSISTENTLY WITH ITS OWN LANGUAGE AND THE STATUTORY PATTERN

A seller is liable under Section 12(2) if it sells securities "by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in light of the circumstances under which they were made, not misleading." The Court of Appeals held that Nuveen sold the commercial paper to every one of the forty-two plaintiffs "by means of" a false prospectus,[21] even though nearly all of the purchasers had never seen or even been aware of the prospectus. The ruling was based on a presumption which Congress apparently rejected in enacting Section 12(2); and in applying such a presumption the ruling expanded Section 12(2) to parallel Section 11 without, however, affording the defendant any of the carefully drafted safeguards included in Section 11. Once again, the Court of Appeals was able to accomplish such a result only by improperly ignoring the statutory pattern established by the express civil liability provisions of the 1933 Act.

A. The Ruling Below

Petitioners contended that only if a purchaser-plaintiff had received the defendant-seller's report on Winter & Hirsch com-

[21]The concept of "prospectus" for purposes of Section 12(2) is broader than the prospectus required in registered offerings. *Compare* Sections 2(10) and 10 of the 1933 Act, 15 U.S.C. §§77b(10) and 77j, respectively. There is no dispute that the Nuveen commercial paper reports on Winter & Hirsch were prospectuses in the broad sense for purposes of Section 12(2). Since those reports reproduced the certified financial statements of Winter & Hirsch—which, unbeknownst to Nuveen, were not accurate—the reports were false in part.

mercial paper prior to purchasing the commercial paper could the sale have been effected "by means of" the report. The evidence established that only three of the forty-two plaintiffs had received a Nuveen report on Winter & Hirsch before they made their purchases. The Court of Appeals held, however, that all plaintiffs could recover.

> Although the statute explicitly requires privity between plaintiff-purchaser and defendant-seller, its terms do not require that the particular sale to an individual plaintiff be directly by means of the prospectus alleged to be misleading.
>
> . . . .
>
> . . . [I]t is enough that the seller sold by means of a misleading prospectus securities of which those purchased by the plaintiff were a part.

(A. 8-9) (footnotes omitted). The rationale of the decision was that the reports created a market for the commercial paper, at least to the extent that the interest rate was determined by the information Nuveen made available about the issuer. (A. 9) "The misleading reports were instrumental to the sales at bar through their effect on the market." (A. 9 n. 7) Further, the court reasoned, if the commercial paper report had disclosed the truth, the market for this commercial paper would have collapsed. (A. 9)

The court below, however, expressly acknowledged the weakness of its own approach when it stated that

> the result might be different if only oral communications were involved. That statute's reference to an oral communication by means of which a security is sold arguably suggests a statement made to the individual buyer of the security.

(A. 9-10 n. 8) If the oral communication must be direct and personal, then so must be the use of the prospectus, because the statute makes no distinction between the two types of communication. The same language ("by means of") cannot have differing

meanings depending upon whether the communication was written or oral. *Cf. Aaron v. Securities and Exchange Commission*, 100 S. Ct. 1945, 1952 (1980) (Rule 10b-5 means the same thing "regardless of the plaintiff or the nature of the relief sought.")

B. Congress Included A Rebuttable Presumption Of Market Impact In Section 11; No Such Presumption Was Included In, Or Should Be Applied In Actions Under, Section 12(2)

The Court of Appeals' rationale for affirming the judgment under Section 12(2) in favor of all plaintiffs, even though only three had received a prospectus before purchasing, was a market impact theory. The sole authority cited for the application of that theory in an action under Section 12(2) was a passage from the House Report on the bill which became the 1933 Act. (A. 8) While this passage ostensibly refers to both Sections 11 and 12, the discussion in the House Report is clearly focused upon registration statements, *i.e.*, upon Section 11. H.R. Rep. No. 85, 73d Cong., 1st Sess. 9-10 (1933). For example, the quoted section of the House Report begins, "Sections 11 and 12 . . . entitle the buyer of securities sold upon a *registration statement* . . . to sue for recovery of his purchase price. . . ." *Id.*, at 9 (emphasis added). The subject of this passage is further clarified by reference to a later, more detailed discussion of Section 11, which refers to security values "affected by the information given in the registration statement" and to granting a remedy to "all purchasers who may reasonably be affected by any statements in the registration statement." H.R. Rep. No. 85, 73d Cong., 1st Sess. 22 (1933). These market impact concepts are not mentioned anywhere in the detailed analysis of Section 12(2) also contained in that report. *Id.*, at 23. Likewise, the language quoted by the Court of Appeals refers to "wide dissemination" (A. 8), a situation which obtains where a registration statement is used, but not necessarily in the Section 12(2) context and certainly not here. Thus, the material

relied upon by the court below delineated the rationale of the structure of Section 11, and has no application to Section 12(2).

A comparison of the context and language of Sections 11 and 12(2) also demonstrates that the market impact theory is reflected in Section 11 alone, giving rise to a compelling inference that no such presumption—let alone an irrebuttable one—should be applied in actions under Section 12(2). Registration statements are in fact *required* to be widely disseminated, particularly during and after an initial public offering. *See* Sections 4(3) and 5 of the 1933 Act, 15 U.S.C. §§77d(3) and 77e; 1 Loss, SECURITIES REGULATION 257-58 (2d ed. 1961); 4 Loss, SECURITIES REGULATION 2327-30 (1969 Supp.). In that context it was reasonable for Congress to presume that the market price of a security would be affected by the registration statement. Accordingly, Congress chose not to impose a burden on a plaintiff to prove causation in an action under Section 11. The buyer need only prove that he purchased a security issued pursuant to the registration statement. *Barnes v. Osofsky*, 373 F.2d 269 (2d Cir. 1967).[22] However, even in this context Congress made the presumption rebuttable by granting a causation defense. Section 11(e) provides that the plaintiff may not recover damages that represent "other than the depreciation in value of such security resulting from [the defective] part of the registration statement".[23] This permits a defendant to show, in effect, that the faulty registration statement did not inflate the market price of the security, by proving that after the sale to plaintiff the market price of the security declined for

[22]One may *not* sue under Section 11, however, as to securities of the same class as those covered by the registration statement but which were not sold pursuant to that registration statement. *Barnes v. Osofsky*, 373 F.2d 269 (2d Cir. 1967). Thus, the scope of Section 11 and of the market impact presumption were strictly limited by Congress.

[23]This defense was added in 1934. Amendments to Securities Act of 1933, Pub. L. 291, §206(d) (1934). At the same time, Congress added a reliance requirement under certain circumstances. *Id.*, §206(a), codified in Section 11(a), 15 U.S.C. §77k(a). No similar changes were made in Section 12(2).

reasons other than disclosure of the facts omitted from or misrepresented in the registration statement. *See, e.g., Feit v. Leasco Data Processing Equipment Corp.*, 332 F.Supp. 544, 586 (E.D.N.Y. 1971).

While it was reasonable to create a rebuttable presumption that a registration statement would have market impact, Congress had no basis to indulge in such a blanket presumption in drafting Section 12(2), since that section applies to *any* "prospectus or oral communication," without regard to any legal requirement or fact of wide dissemination. Since Congress included no such presumption, it imposed an affirmative burden of proof of causation in the form of the "by means of" requirement. It is, therefore, singularly inappropriate for a court to supply by interpretation a presumption under Section 12(2), but that is precisely what the Court of Appeals did here.

The fact that the court below applied a presumption is established by the absence of any meaningful analysis of the record by it. There were no findings demonstrating that the market was *in fact* either created or sustained by Nuveen's few reports. Winter & Hirsch commercial paper had been sold for decades before Nuveen began to sell it less than a year before the first purchase at issue here. The market could just as well have been sustained by inertia, by Winter & Hirsch's established credit standing with major Chicago and other banks, by word of mouth not emanating from Nuveen, by dissemination by others of the Lieber, Bleiweis audit reports themselves, by the reports on Winter & Hirsch disseminated by the National Credit Office (a commercial paper rating agency), or by a combination of those and other factors. Finally, the Court of Appeals did not take into account that many sales at issue in this case preceded distribution of the three commercial paper reports received by plaintiffs, so that the reports relied upon by the court below could but have created or sustained the "market" in which the early purchases occurred. The court improperly presumed market impact.

Moreover, the presumption as applied by the Court of Appeals was virtually irrebuttable. Under the Court of Appeals' theory, a single document sent to a single purchaser among numerous claimants would satisfy the "by means of" requirement for all claimants since (by hypothesis) disclosure of the truth in that single document would have destroyed a market which (by hypothesis) was sustained by the single report. Nothing in the court's analysis permits line-drawing to determine how much dissemination is enough—in the instant case three, or perhaps one,[24] of forty-two was enough. Thus, the Court of Appeals applied an irrebuttable presumption where Congress rejected even a rebuttable one.[25]

C. The Decision Below Is Inconsistent With Decisions Of Other Courts Construing Section 12(2)

This market impact interpretation of Section 12(2) is not only at odds with the statutory pattern but, not surprisingly, is inconsistent with prior readings of Section 12(2). For example, this Court has described Section 12(2) as establishing a cause of action against the seller "with respect to prospectuses and communication *to* 'the person purchasing such security from him.' " *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 728 (1975)

[24]The court below held that Nuveen could be held liable under Section 12(2) "without reference to the evidence adduced at the [post-*Sanders III*] evidentiary hearing." (A. 3 n. 2) Yet prior to that hearing only one plaintiff had proved receipt of a commercial paper report, and it was later established that he did not actually see the report until three weeks after his purchase.

[25]This Court has often condemned the use of presumptions as a substitute for more searching inquiry. *See, e.g., Vlandis v. Kline*, 412 U.S. 441, 446, 452 (1973) (it is unfair to employ a "permanent and irrebuttable presumption . . . [which] is not necessarily or universally true in fact" where there are "reasonable alternative means of making the crucial determination"); *Cleveland Bd. of Education v. La Fleur*, 414 U.S. 632, 644-45 (1974). While no constitutional claim is made here, the principles underlying this Court's skepticism about irrebuttable presumptions serve equally well here, particularly in light of the statutory pattern discussed in the text.

(emphasis added). This description is in accordance with the plain meaning of Section 12(2), *i.e.*, that the challenged communication must be made directly to the plaintiff.

Other federal courts, relying on the plain meaning of Section 12(2), have held that the plaintiff must *prove* causation, as described above, in order to sustain a cause of action. In *Lorber v. Beebe*, 407 F.Supp. 279 (S.D.N.Y. 1976), the plaintiff purchased securities two weeks after commencement of a public offering which, of course, entailed wide dissemination of the prospectus. On the Section 12(2) claim the District Court granted summary judgment to plaintiff's seller, one of the underwriters of the public offering, on the ground that the seller did not supply plaintiff with a prospectus and so the sale had not been "by means of" the prospectus. 407 F.Supp. at 295-96. The decision below is squarely in conflict with *Lorber*.

Similarly, in *Jackson v. Oppenheim*, 533 F.2d 826 (2d Cir. 1976), the court held, "[T]he communication must have been intended or perceived as instrumental in effecting the sale." 533 F.2d at 830 n. 8. A plaintiff who never received the commercial paper report could not have "perceived" it as anything. If Nuveen did not send a report to that plaintiff it could not have been "intended" to effect that sale. *See also Mason v. Marshall*, 412 F.Supp. 294, 301 (N.D.Tex. 1974) (alternative holding), *aff'd per curiam*, 531 F.2d 1274 (5th Cir. 1976), where the District Court held that where the prospectus was received after the plaintiff had communicated to the buyer his decision to buy there was no basis for liability under Section 12(2).

D. The Decision Below, Especially When Coupled With Other Recent, Questionable Interpretations of Section 12(2), Threatens To Destroy The Statutory Pattern Of The 1933 Act.

The virtual elimination of the "by means of" element of the cause of action under Section 12(2) is particularly troublesome if

it is applied in conjunction with the growing line of cases which, erroneously in petitioners' view, eliminate the statutory privity requirement in actions under Section 12(2).[26] These concurrent developments effectively grant a cause of action to purchasers with only the most remote contact with the seller, since neither direct communication nor strict privity is required. This further contravenes the carefully formulated pattern established by Congress.

Congress enacted various safeguards where there is no privity requirement. Section 11 has no privity requirement, but significantly limits the total damages which can be assessed. For example, an underwriter cannot be held liable "for damages in excess of the total price at which the securities underwritten *by him* and distributed to the public were offered to the public." Section 11(e)[27] (emphasis added). Presumably Congress did not insert such protections into Section 12(2) because they were thought to be superfluous; Section 12(2) required both privity and direct dealing between plaintiff and defendant. The judicial rejection of those two limitations without a corresponding implemen-

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[26] *See, e.g., Hill York Corp. v. American Int'l Franchises, Inc.*, 448 F.2d 680, 695 (5th Cir. 1971); *Vogel v. Trahan*, FED.SEC.L.REP. (CCH) ¶97,303, at pp. 97,082-83 (E.D. Pa. 1980) [1979-80 Transfer Binder]; *Stern v. American Bankshares Corp.*, 429 F.Supp. 818, 824 (E.D. Wis. 1977); *Sandusky Land, Ltd. v. Uniplan Groups*, 400 F.Supp. 440, 444 (N.D. Ohio 1975); *In re Caesars Palace Securities Litigation*, 360 F.Supp. 366, 378-83 (S.D.N.Y. 1973), imposing Section 12(2) liability on mere participants in and aiders and abettors of the sale. *But see*, requiring strict privity, *Collins v. Signetics Corp.*, 605 F.2d 110, 113 (3d Cir. 1979); *McFarland v. Memorex Corp.*, FED.SEC.L.REP. (CCH) ¶97,368, at pp. 97,461-62 (N.D. Cal. 1980) [1979-80 Transfer Binder]. According to the court below, Section 12(2) requires privity between buyer and seller. (A. 8, 14) However, the Court of Appeals paid that "requirement" lip service at best, since it denied rehearing when defendants demonstrated that there were at least two intermediaries between Nuveen and four of the plaintiffs.

[27] The cited portion of Section 11(e) was added in 1934. Amendments to Securities Act of 1933, Pub. L. 291, §206(e) (1934).

tation of restrictions such as those contained in Section 11(e) patently destroys the statutory pattern.[28] *See, e.g., In re Gap Stores Securities Litigation*, 79 F.R.D. 283, 307 (N.D.Cal. 1978) (if Section 12(2) does not require privity, the Section 12(2) liability of an underwriter of a public offering could improperly exceed the damage limitations imposed by Section 11(e)). A market impact theory may be viable under Rule 10b-5 in the absence of privity. *See, e.g., Blackie v. Barrack*, 524 F.2d 891, 907 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976). But such extensive liability under Rule 10b-5 may be sustained only if scienter is proven — a far more appropriate standard in such circumstances than the reasonable care defense as construed by the court below.

The decision below transforms Section 12(2) into a cause of action for engaging in a negligent course of business, not unlike many pre-*Hochfelder* interpretations of Rule 10b-5(c). Yet the very essence of this Court's ruling in *Hochfelder* was to prevent the use of Rule 10b-5 as the basis for a cause of action for negligence without the explicit limitations found in the express liability provisions, such as Section 12(2). 425 U.S. at 207-11. The court below has now removed those very limitations from Section 12(2) itself!

SUMMARY

The decision below—alleviating plaintiff's burden of proof, expanding the class of plaintiffs and increasing substantially a defendant's burden of reasonable care—destroys the carefully

[28]Consider the following comparison. If Nuveen had been but one of several dealers in Winter & Hirsch commercial paper, under petitioners' reading of Section 12(2) Nuveen's liability, if any, would have been to those to whom it made statements actionable under Section 12(2) and with whom it was in privity. Under the market impact presumption applied below, however, Nuveen's liability could extend to all of the customers of the other dealers as well, even though Nuveen's reports never reached them and they were not in privity with Nuveen. Still more draconian, in order to sustain the reasonable care defense Nuveen would have to show that it virtually retraced the steps of the issuer's independent accountant.

wrought interrelationship of Sections 11 and 12(2) and of all of the implied and express civil liability provisions, which this Court delineated in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), and *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975). In particular, the decision below ignores, or actually reverses, distinctions between two sections of the same statute obviously related to the fact that one (Section 11) applies only to registered public offerings whereas the other (Section 12(2)) applies to all sales of securities, including commercial paper (as in the instant case) and other exempt securities. To paraphrase this Court's statement in *Touche Ross & Co. v. Redington*, 442 U.S. 560, 578 (1979), quoting *Securities and Exchange Commission v. Sloan*, 436 U.S. 103, 116 (1978), generalized references to the remedial purposes of the 1933 Act "will not justify reading a provision 'more broadly than its language and the statutory scheme reasonably permit.'"

CONCLUSION

For the reasons given, petitioners pray that a writ be granted to review the judgment and opinion below.

Respectfully submitted,

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STATUTORY APPENDIX

Section 11 of the Securities Act of 1933, 15 U.S.C. §77k

(a) In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue—

(1) every person who signed the registration statement;

(2) every person who was a director of (or person performing similar functions) or partner in, the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him;

(5) every underwriter with respect to such security.

If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement, then the right of recovery under this subsection shall be conditioned on proof that such person acquired the security relying upon such untrue statement in the registration statement or relying upon the registration statement and not knowing

of such omission, but such reliance may be established without proof of the reading of the registration statement by such person.

(b) Notwithstanding the provisions of subsection (a) no person, other than the issuer, shall be liable as provided therein who shall sustain the burden of proof—

(1) that before the effective date of the part of the registration statement with respect to which his liability is asserted (A) he had resigned from or had taken such steps as are permitted by law to resign from, or ceased or refused to act in, every office, capacity, or relationship in which he was described in the registration statement as acting or agreeing to act, and (B) he had advised the Commission and the issuer in writing that he had taken such action and that he would not be responsible for such part of the registration statement; or

(2) that if such part of the registration statement became effective without his knowledge, upon becoming aware of such fact he forthwith acted and advised the Commission, in accordance with paragraph (1) of this subsection, and, in addition, gave reasonable public notice that such part of the registration statement had become effective without his knowledge; or

(3) that (A) as regards any part of the registration statement not purporting to be made on the authority of an expert, and not purporting to be a copy of or extract from a report or valuation of an expert, and not purporting to be made on the authority of a public official document or statement, he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading; and (B) as regards any part of the registration statement purporting to be made upon his authority as an expert or purporting to be a copy of or extract from a report or valuation of himself as an expert, (i) be had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the

registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or (ii) such part of the registration statement did not fairly represent his statement as an expert or was not a fair copy of or extract from his report or valuation as an expert; and (C) as regards any part of the registration statement purporting to be made on the authority of an expert (other than himself) or purporting to be a copy of or extract from a report or valuation of an expert (other than himself), he had no reasonable ground to believe, and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement of the expert or was not a fair copy of or extract from the report or valuation of the expert; and (D) as regards any part of the registration statement purporting to be a statement made by an official person or purporting to be a copy of or extract from a public official document, he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue, or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement made by the official person or was not a fair copy of or extract from the public official document.

(c) In determining, for the purpose of paragraph (3) of subsection (b) of this section, what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a prudent man in the management of his own property.

(d) If any person becomes an underwriter with respect to the security after the part of the registration statement with respect

to which his liability is asserted has become effective, then for the purposes of paragraph (3) of subsection (b) of this section such part of the registration statement shall be considered as having become effective with respect to such person as of the time when he became an underwriter.

(e) The suit authorized under subsection (a) of this section may be to recover such damages as shall represent the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and (1) the value thereof as of the time such suit was brought, or (2) the price at which such security shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and the value thereof as of the time such suit was brought: *Provided*, That if the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable. In no event shall any underwriter (unless such underwriter shall have knowingly received from the issuer for acting as an underwriter some benefit, directly or indirectly, in which all other underwriters similarly situated did not share in proportion to their respective interests in the underwriting) be liable in any suit or as a consequence of suits authorized under subsection (a) for damages in excess of the total price at which the securities underwritten by him and distributed to the public were offered to the public. In any suit under this or any other section of this title the court may, in its discretion, require an undertaking for the payment of the costs of such suit, including

reasonable attorney's fees, and if judgment shall be rendered against a party litigant, upon the motion of the other party litigant, such costs may be assessed in favor of such party litigant (whether or not such undertaking has been required) if the court believes the suit or the defense to have been without merit, in an amount sufficient to reimburse him for the reasonable expenses incurred by him, in connection with such suit, such costs to be taxed in the manner usually provided for taxing of costs in the court in which the suit was heard.

(f) All or any one or more of the persons specified in subsection (a) shall be jointly and severally liable, and every person who becomes liable to make any payment under this section may recover contribution as in cases of contract from any person who, if sued separately, would have been liable to make the same payment, unless the person who has become liable was, and the other was not, guilty of fraudulent misrepresentation.

(g) In no case shall the amount recoverable under this section exceed the price at which the security was offered to the public.

Section 12 the Securities Act of 1933, 15 U.S.C. §771

Any person who—

(1) offers or sells a security in violation of section 5, or

(2) offers or sells a security (whether or not exempted by the provisions of section 3, other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of

reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.